

GENERAL ASSEMBLY OF NORTH CAROLINA  
SESSION 2003

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SENATE BILL 549  
Judiciary II Committee Substitute Adopted 4/22/03  
House Committee Substitute Favorable 6/2/03

Short Title: Uniform Principal and Income Act.

(Public)

Sponsors:

Referred to:

March 27, 2003

1 A BILL TO BE ENTITLED  
2 AN ACT TO ADOPT THE REVISED UNIFORM PRINCIPAL AND INCOME ACT.  
3 The General Assembly of North Carolina enacts:

4 SECTION 1. Chapter 37 of the General Statutes is repealed.

5 SECTION 2. The General Statutes are amended by adding a new Chapter to  
6 read:

7 **Chapter 37A.**

8 **Uniform Principal and Income Act.**

9 **Article 1.**

10 **Definitions and Fiduciary Duties; Conversion to Unitrust; Judicial Control of**  
11 **Discretionary Power.**

12 **Part 1. Definitions.**

13 **§ 37A-1-101. Short title.**

14 **This Chapter may be cited as the Uniform Principal and Income Act.**

15 **§ 37A-1-102. Definitions.**

16 **The following definitions apply in this Chapter:**

17 (1) **"Accounting period" means a calendar year unless another 12-month**  
18 **period is selected by a fiduciary. The term includes a portion of a**  
19 **calendar year or other 12-month period that begins when an income**  
20 **interest begins or ends when an income interest ends.**

21 (2) **"Beneficiary" includes, in the case of a decedent's estate, an heir,**  
22 **legatee, and devisee and, in the case of a trust, an income beneficiary**  
23 **and a remainder beneficiary.**

24 (3) **"Fiduciary" means a personal representative or a trustee. The term**  
25 **includes an executor, administrator, successor personal representative,**  
26 **special administrator, and a person performing substantially the same**  
27 **function.**

- 1           (4)    "Income" means money or property that a fiduciary receives as current  
2           return from a principal asset. The term includes a portion of receipts  
3           from a sale, exchange, or liquidation of a principal asset, to the extent  
4           provided in Article 4 of this Chapter.
- 5           (5)    "Income beneficiary" means a person to whom net income of a trust is  
6           or may be payable.
- 7           (6)    "Income interest" means the right of an income beneficiary to receive  
8           all or part of net income, whether the terms of the trust require it to be  
9           distributed or authorize it to be distributed in the trustee's discretion.
- 10          (7)    "Mandatory income interest" means the right of an income beneficiary  
11          to receive net income that the terms of the trust require the fiduciary to  
12          distribute.
- 13          (8)    "Net income" means the total receipts allocated to income during an  
14          accounting period minus the disbursements made from income during  
15          the period, plus or minus transfers under this Chapter to or from  
16          income during the period.
- 17          (9)    "Person" means an individual, corporation, business trust, estate, trust,  
18          partnership, limited liability company, association, joint venture, or  
19          government; governmental subdivision, agency, or instrumentality;  
20          public corporation, or any other legal or commercial entity.
- 21          (10)   "Principal" means property held in trust for distribution to a remainder  
22          beneficiary when the trust terminates.
- 23          (11)   "Remainder beneficiary" means a person entitled to receive principal  
24          when an income interest ends.
- 25          (12)   "Terms of a trust" means the manifestation of the intent of a settlor or  
26          decedent with respect to the trust, expressed in a manner that admits of  
27          its proof in a judicial proceeding, whether by written or spoken words  
28          or by conduct.
- 29          (13)   "Trustee" includes an original, additional, or successor trustee, whether  
30          or not appointed or confirmed by a court.

31    **"§ 37A-1-103. Fiduciary duties; general principles.**

32          (a)    In allocating receipts and disbursements to or between principal and income,  
33          and with respect to any matter within the scope of Articles 2 and 3 of this Chapter, a  
34          fiduciary:

- 35               (1)    Shall administer a trust or estate in accordance with the terms of the  
36               trust or the will, even if there is a different provision in this Chapter;
- 37               (2)    May administer a trust or estate by the exercise of a discretionary  
38               power of administration given to the fiduciary by the terms of the trust  
39               or the will, even if the exercise of the power produces a result different  
40               from a result required or permitted by this Chapter;
- 41               (3)    Shall administer a trust or estate in accordance with this Chapter if the  
42               terms of the trust or the will do not contain a different provision or do  
43               not give the fiduciary a discretionary power of administration; and

1           (4) Shall add a receipt or charge a disbursement to principal to the extent  
2           that the terms of the trust and this Chapter do not provide a rule for  
3           allocating the receipt or disbursement to or between principal and  
4           income.

5           (b) In exercising the power to adjust under G.S. 37A-1-104(a), any discretionary  
6           power in connection with the conversion or administration of a unitrust under Part 2 of  
7           this Article, or a discretionary power of administration regarding a matter within the  
8           scope of this Chapter, whether granted by the terms of a trust, a will, or this Chapter, a  
9           fiduciary shall administer a trust or estate impartially, based on what is fair and  
10           reasonable to all of the beneficiaries, except to the extent that the terms of the trust or  
11           the will clearly manifest an intention that the fiduciary shall or may favor one or more  
12           of the beneficiaries. A determination in accordance with this Chapter is presumed to be  
13           fair and reasonable to all of the beneficiaries.

14           (c) The exercise of powers of allocation of receipts and expenditures contained  
15           or incorporated by reference to G.S. 32-27(29) in wills dated prior to January 1, 2004,  
16           shall continue to be valid.

17           **"§ 37A-1-104. Trustee's power to adjust.**

18           (a) A trustee may adjust between principal and income to the extent the trustee  
19           considers necessary if the trustee invests and manages trust assets as a prudent investor,  
20           the terms of the trust describe the amount that may or shall be distributed to a  
21           beneficiary by referring to the trust's income, and the trustee determines, after applying  
22           the rules in G.S. 37A-1-103(a), that the trustee is unable to comply with G.S.  
23           37A-1-103(b). In lieu of exercising the power to adjust, the trustee may convert the trust  
24           to a unitrust as permitted under Part 2 of this Article, in which case the unitrust amount  
25           shall become the net income of the trust.

26           (b) In deciding whether and to what extent to exercise the power conferred by  
27           subsection (a) of this section, a trustee shall consider all factors relevant to the trust and  
28           its beneficiaries, including the following factors to the extent they are relevant:

29           (1) The nature, purpose, and expected duration of the trust;

30           (2) The intent of the grantor or settlor;

31           (3) The identity and circumstances of the beneficiaries;

32           (4) The needs for liquidity, regularity of income, and preservation and  
33           appreciation of capital;

34           (5) The assets held in the trust; the extent to which they consist of  
35           financial assets, interests in closely held enterprises, tangible and  
36           intangible personal property, or real property; the extent to which an  
37           asset is used by a beneficiary; and whether an asset was purchased by  
38           the trustee or received from the settlor;

39           (6) The net amount allocated to income under the other sections of this  
40           Chapter and the increase or decrease in the value of the principal  
41           assets, which the trustee may estimate as to assets for which market  
42           values are not readily available;

43           (7) Whether and to what extent the terms of the trust give the trustee the  
44           power to invade principal or accumulate income or prohibit the trustee

- 1                   from invading principal or accumulating income, and the extent to  
2                   which the trustee has exercised a power from time to time to invade  
3                   principal or accumulate income;
- 4           (8)   The actual and anticipated effect of economic conditions on principal  
5                   and income and effects of inflation and deflation; and
- 6           (9)   The anticipated tax consequences of an adjustment.
- 7   (c)   A trustee shall not make an adjustment:
- 8           (1)   That diminishes the income interest in a trust that requires all of the  
9                   income to be paid at least annually to a spouse and for which an estate  
10                  tax or gift tax marital deduction would be allowed, in whole or in part,  
11                  if the trustee did not have the power to make the adjustment;
- 12           (2)   That reduces the actuarial value of the income interest in a trust to  
13                  which a person transfers property with the intent to qualify for a gift  
14                  tax exclusion;
- 15           (3)   That changes the amount payable to a beneficiary as a fixed annuity or  
16                  a fixed fraction of the value of the trust assets;
- 17           (4)   From any amount that is permanently set aside for charitable purposes  
18                  under a will or the terms of a trust unless both income and principal  
19                  are so set aside;
- 20           (5)   If possessing or exercising the power to make an adjustment causes an  
21                  individual to be treated as the owner of all or part of the trust for  
22                  income tax purposes and the individual would not be treated as the  
23                  owner if the trustee did not possess the power to make an adjustment;
- 24           (6)   If possessing or exercising the power to make an adjustment causes all  
25                  or part of the trust assets to be included for estate tax purposes in the  
26                  estate of an individual who has the power to remove a trustee or  
27                  appoint a trustee, or both, and the assets would not be included in the  
28                  estate of the individual if the trustee did not possess the power to make  
29                  an adjustment;
- 30           (7)   If the trustee is a beneficiary of the trust;
- 31           (8)   If the trustee is not a beneficiary but the adjustment would benefit the  
32                  trustee directly or indirectly; or
- 33           (9)   If the trust has been converted to, and is then operating as, a unitrust  
34                  under Part 2 of this Article.
- 35   (d)   If subdivision (5), (6), (7), or (8) of subsection (c) of this section applies to a  
36           trustee and there is more than one trustee, a cotrustee to whom the provision does not  
37           apply may make the adjustment unless the exercise of the power by the remaining  
38           trustee or trustees is not permitted by the terms of the trust.
- 39   (e)   A trustee may renounce the entire power conferred by subsection (a) of this  
40           section or may renounce only the power to adjust from income to principal or the power  
41           to adjust from principal to income if the trustee is uncertain about whether possessing or  
42           exercising the power will cause a result described in subdivisions (1) through (6) or  
43           subdivision (8) of subsection (c) of this section or if the trustee determines that  
44           possessing or exercising the power will or may deprive the trust of a tax benefit or

1 impose a tax burden not described in subsection (c) of this section. The renunciation  
2 may be permanent or for a specified period, including a period measured by the life of  
3 an individual.

4 (f) Terms of a trust that limit the power of a trustee to make an adjustment  
5 between principal and income do not affect the application of this section unless it is  
6 clear from the terms of the trust that the terms are intended to deny the trustee the power  
7 of adjustment conferred by subsection (a) of this section.

8 "Part 2. Conversion to Unitrust.

9 **"§ 37A-1-104.1. Definitions.**

10 For purposes of this Part:

11 (1) "Code" means the Internal Revenue Code of 1986, as amended from  
12 time to time, and any statutory enactment successor to the Code;  
13 reference to a specific section of the Code in this Part shall be  
14 considered a reference also to any successor provision dealing with the  
15 subject matter of that section of the Code.

16 (2) "Competent beneficiary" includes:

17 a. A beneficiary who has attained the age of 18 and is not  
18 otherwise under a legal disability;

19 b. A court-appointed guardian of an incompetent beneficiary;

20 c. An attorney-in-fact or agent under a durable power of attorney  
21 for an incompetent beneficiary;

22 d. A court-appointed guardian of a minor beneficiary's estate; and

23 e. In the case of a minor beneficiary for whom no guardian has  
24 been appointed, a parent of the minor beneficiary, but only if  
25 the parent does not have an interest in the estate or trust that  
26 conflicts with the interest of the minor beneficiary.

27 (3) "Grantor" means an individual who created an inter vivos trust.

28 (4) "Disinterested person" means a person who is not a related or  
29 subordinate party with respect to the person then acting as trustee of  
30 the trust and excludes the grantor of the trust and any interested  
31 trustee.

32 (5) "Income trust" means a trust, created by either an inter vivos or a  
33 testamentary instrument, which directs or permits the trustee to  
34 distribute the net income of the trust to one or more persons, either in  
35 fixed proportions or in amounts or proportions determined by the  
36 trustee. Notwithstanding the foregoing, no trust that may be subject to  
37 taxation under section 2001 or section 2501 of the Code shall be an  
38 income trust for purposes of this Part, until the expiration of the period  
39 for filing the return therefor, including all extensions for the filing.

40 (6) "Interested distributee" means a person to whom distributions of  
41 income or principal can currently be made who has the power to  
42 remove the existing trustee and designate as successor a person who  
43 may be a related or subordinate party with respect to that distributee.

- 1           (7)    "Interested trustee" means (i) an individual trustee to whom the net  
2           income or principal of the trust can currently be distributed or would  
3           be distributed if the trust were then to terminate and be distributed, (ii)  
4           any trustee who may be removed and replaced by an interested  
5           distributee, or (iii) an individual trustee whose legal obligation to  
6           support a beneficiary may be satisfied by distributions of income and  
7           principal of the trust.
- 8           (8)    "Related or subordinate party" means a related or subordinate party as  
9           defined in section 672(c) of the Code.
- 10          (9)    "Total return unitrust" means an income trust that has been converted  
11          under and meets the provisions of this Part.
- 12          (10)   "Trustee" means any person acting as trustee of the trust, except as  
13          otherwise expressly provided in this Part, whether acting in that  
14          person's discretion or on the direction of one or more persons acting in  
15          a fiduciary capacity.
- 16          (11)   "Unitrust amount" means an amount computed as a percentage of the  
17          fair market value of the trust.

18    **"§ 37A-1-104.2. Conversion in trustee's discretion without court approval.**

19          (a)    Any trustee, other than an interested trustee, or, where two or more persons  
20          are acting as trustees, a majority of the trustees who are not interested trustees (in either  
21          case hereafter "trustee"), may, in the trustee's sole discretion and without court approval,  
22          (i) convert an income trust to a total return unitrust, (ii) reconvert a total return unitrust  
23          to an income trust, or (iii) change the percentage used to calculate the unitrust amount or  
24          the method used to determine the fair market value of the trust if:

- 25               (1)    The trustee adopts a written policy for the trust providing (i) in the  
26               case of a trust being administered as an income trust, that future  
27               distributions from the trust will be unitrust amounts rather than net  
28               income, (ii) in the case of a trust being administered as a total return  
29               unitrust, that future distributions from the trust will be net income  
30               rather than unitrust amounts, or (iii) that the percentage used to  
31               calculate the unitrust amount or the method used to determine the fair  
32               market value of the trust will be changed as stated in the policy;
- 33               (2)    The trustee sends written notice of its intention to take the action,  
34               along with copies of the written policy and this Part, to (i) the grantor  
35               of the trust, if living, (ii) all the competent beneficiaries who are  
36               currently receiving or eligible to receive distributions of income of the  
37               trust, (iii) all the competent beneficiaries who would receive principal  
38               of the trust if the trust were to terminate at the time of the giving of the  
39               notice (without regard to the exercise of any power of appointment),  
40               and (iv) all persons acting as advisor or protector of the trust;
- 41               (3)    There is at least one competent beneficiary who is currently receiving  
42               or eligible to receive distributions of income of the trust and there is at  
43               least one competent beneficiary who would receive principal of the

1 trust if the trust were to terminate at the time of the giving of the  
2 notice; and

3 (4) No person receiving notice of the trustee's intention to take the  
4 proposed action of the trustee objects to the action within 60 days of  
5 receipt of the notice by written instrument delivered to the trustee.

6 (b) If there is no trustee of the trust other than an interested trustee, the interested  
7 trustee or, where two or more persons are acting as trustee and are interested trustees, a  
8 majority of the interested trustees may, in its sole discretion and without court approval,  
9 (i) convert an income trust to a total return unitrust, (ii) reconvert a total return unitrust  
10 to an income trust, or (iii) change the percentage used to calculate the unitrust amount or  
11 the method used to determine the fair market value of the trust if:

12 (1) The trustee adopts a written policy for the trust providing (i) in the  
13 case of a trust being administered as an income trust, that future  
14 distributions from the trust will be unitrust amounts rather than net  
15 income as determined under this Chapter, (ii) in the case of a trust  
16 being administered as a total return unitrust, that future distributions  
17 from the trust will be net income as determined under this Chapter  
18 rather than unitrust amounts, or (iii) that the percentage used to  
19 calculate the unitrust amount or the method used to determine the fair  
20 market value of the trust will be changed as stated in the policy;

21 (2) The trustee appoints a disinterested person who, in its sole discretion  
22 but acting in a fiduciary capacity, determines for the trustee (i) the  
23 percentage to be used to calculate the unitrust amount, (ii) the method  
24 to be used in determining the fair market value of the trust, and (iii)  
25 which assets, if any, are to be excluded in determining the unitrust  
26 amount;

27 (3) The trustee sends written notice of its intention to take the action,  
28 along with copies of the written policy and this Part, and the  
29 determinations of the disinterested person to (i) the grantor of the trust,  
30 if living, (ii) all the competent beneficiaries who are currently  
31 receiving or eligible to receive distributions of income of the trust, (iii)  
32 all the competent beneficiaries who would receive principal of the trust  
33 if the trust were to terminate at the time of the giving of the notice  
34 (without regard to the exercise of any power of appointment), and (iv)  
35 all persons acting as advisor or protector of the trust;

36 (4) There is at least one competent beneficiary who is currently receiving  
37 or eligible to receive distributions of income of the trust and there is at  
38 least one competent beneficiary who would receive principal of the  
39 trust if the trust were to terminate at the time of the giving of the  
40 notice; and

41 (5) No person receiving notice of the trustee's intention to take the  
42 proposed action of the trustee objects to the action or to the  
43 determination of the disinterested person within 60 days of receipt of  
44 the notice by written instrument delivered to the trustee.

1 **"§ 37A-1-104.3. Conversion with court approval.**

2 (a) If any trustee desires to (i) convert an income trust to a total return unitrust,  
3 (ii) reconvert a total return unitrust to an income trust, or (iii) change the percentage  
4 used to calculate the unitrust amount or the method used to determine the fair market  
5 value of the trust but does not have the ability to or elects not to do it under G.S.  
6 36A-1-104.2, the trustee may petition the court for an order as the trustee considers  
7 appropriate. In the event, however, there is only one trustee of the trust and the trustee is  
8 an interested trustee or in the event there are two or more trustees of the trust and a  
9 majority of them are interested trustees, the court, in its own discretion or on the petition  
10 of the trustee or trustees or any person interested in the trust, may appoint a disinterested  
11 person who, acting in a fiduciary capacity, shall present information to the court as shall  
12 be necessary to enable the court to make its determinations under this Part.

13 (b) A competent beneficiary may request the trustee to (i) convert an income trust  
14 to a total return unitrust, (ii) reconvert a total return unitrust to an income trust, or (iii)  
15 change the percentage used to calculate the unitrust amount or the method used to  
16 determine the fair market value of the trust. If the trustee does not take the action  
17 requested, the competent beneficiary may petition the court to order the trustee to take  
18 the action.

19 (c) All proceedings under this section shall be conducted as provided in Article 3  
20 of Chapter 36A of the General Statutes.

21 **"§ 37A-1-104.4. Determination of unitrust amount.**

22 (a) The fair market value of the trust shall be determined at least annually, using  
23 a valuation date selected by the trustee in its discretion. The trustee, in its discretion,  
24 may use an average of the fair market value on the same valuation date for the current  
25 fiscal year and not more than three preceding fiscal years, if the use of this average  
26 appears desirable to reduce the impact of fluctuations in market value on the unitrust  
27 amount. Assets for which a fair market value cannot be readily ascertained shall be  
28 valued using valuation methods as are considered reasonable and appropriate by the  
29 trustee. These assets may be excluded from valuation, provided all income received  
30 with respect to these assets is distributed to the extent distributable in accordance with  
31 the terms of the governing instrument.

32 (b) The percentage to be used in determining the unitrust amount shall be a  
33 reasonable current return from the trust, in any event not less than three percent (3%)  
34 nor more than five percent (5%), taking into account the intentions of the grantor of the  
35 trust as expressed in the governing instrument, the needs of the beneficiaries, general  
36 economic conditions, projected current earnings and appreciation for the trust, and  
37 projected inflation and its impact on the trust.

38 (c) In the case of a trust (i) for which a marital deduction has been taken for  
39 federal tax purposes under section 2056 or section 2523 of the Code (during the lifetime  
40 of the spouse for whom the trust was created) or (ii) a trust to which the  
41 generation-skipping transfer tax due under section 2601 of the Code does not apply by  
42 reason of any effective date or transition rule, the unitrust amount in any taxable year  
43 shall not be less than the net income of the trust, determined without regard to  
44 subsection (d) of this section.



1       (d) Following the conversion of an income trust to a total return unitrust, the  
2 trustee:

- 3           (1) Shall treat the unitrust amount as if it were net income of the trust for  
4 purposes of determining the amount available, from time to time, for  
5 distribution from the trust; and
- 6           (2) May allocate to trust income for each taxable year of the trust (or  
7 portion of that year) (i) net short-term capital gain described in section  
8 1222(5) of the Code for that year or portion of that year, but only to  
9 the extent that the amount allocated together with all other amounts  
10 allocated to trust income for that year or portion of that year does not  
11 exceed the unitrust amount for that year or portion of that year; and (ii)  
12 net long-term capital gain described in section 1222(7) of the Code for  
13 that year or portion of that year, but only to the extent that the amount  
14 allocated together with all other amounts, including amounts described  
15 in clause (i) above, allocated to trust income for that year or portion of  
16 that year does not exceed the unitrust amount for that year or portion  
17 of that year.

18 **"§ 37A-1-104.5. Matters in trustee's discretion.**

19       In administering a total return unitrust, the trustee may, in its sole discretion but  
20 subject to the provisions of the governing instrument, determine:

- 21           (1) The effective date of the conversion;  
22           (2) The timing of distributions, including provisions for prorating a  
23 distribution for a short year in which a beneficiary's right to payments  
24 commences or ceases;
- 25           (3) Whether distributions are to be made in cash or in kind or partly in  
26 cash and partly in kind;
- 27           (4) If the trust is reconverted to an income trust, the effective date of the  
28 reconversion; and
- 29           (5) Any other administrative issues as may be necessary or appropriate to  
30 carry out the purposes of this Part.

31 **"§ 37A-1-104.6. No effect on principal distributions.**

32       Conversion to a total return unitrust under this Part shall not affect any other  
33 provision of the governing instrument, if any, regarding distributions of principal. For  
34 purposes of this Part, the distribution of a unitrust amount is considered a distribution of  
35 income and not of principal.

36 **"§ 37A-1-104.7. Marital deduction trusts.**

37       Notwithstanding anything in this Part to the contrary, in the case of any trust for  
38 which a marital deduction has been taken, in whole or in part, for federal tax purposes  
39 under section 2056 or section 2523 of the Code, the spouse otherwise entitled to receive  
40 the net income of the trust shall have the right, by written instrument delivered to the  
41 trustee, to compel for the spouse's lifetime (i) the conversion of the trust from an income  
42 trust to a total return unitrust or (ii) the reconversion of the trust from a total return  
43 unitrust to an income trust.

1 **"§ 37A-1-104.8. No liability on part of trustee or disinterested person acting in**  
2 **good faith.**

3 No trustee or disinterested person who in good faith takes or fails to take any action  
4 under this Part shall be liable to any person affected by the action or inaction, regardless  
5 of whether the person received written notice as provided in this Part and regardless of  
6 whether the person was under a legal disability at the time of the delivery of the notice.  
7 The exclusive remedy for any person affected by an action or inaction shall be to obtain  
8 an order of the court directing the trustee (i) to convert an income trust to a total return  
9 unitrust, (ii) to reconvert from a total return unitrust to an income trust, or (iii) to change  
10 the percentage used to calculate the unitrust amount.

11 **"§ 37A-1-104.9. Applicability.**

12 This Part shall apply to all trusts in existence on, or created after January 1, 2004,  
13 unless (i) the governing instrument contains a provision clearly expressing the grantor's  
14 intention that the current beneficiary or beneficiaries are to receive an amount other than  
15 a reasonable current return from the trust, (ii) the trust is a trust described in section  
16 170(f)(2)(B), section 664(d), section 2702(a)(3), or section 2702(b) of the Code, (iii)  
17 one or more persons to whom the trustee could distribute income has a power of  
18 withdrawal over the trust that is not subject to an ascertainable standard under section  
19 2041 or section 2514 of the Code, or the power of withdrawal can be exercised to  
20 discharge a duty of support the person possesses, or (iv) the governing instrument  
21 expressly prohibits use of this Part by specific reference to this Part.

22 "Part 3. Judicial Control of Discretionary Power.

23 **"§ 37A-1-105. Judicial control of discretionary power.**

24 (a) The court shall not order a fiduciary to change a decision to exercise or not to  
25 exercise a discretionary power conferred by this Chapter unless it determines that the  
26 decision was an abuse of the fiduciary's discretion. A fiduciary's decision is not an abuse  
27 of discretion merely because the court would have exercised the power in a different  
28 manner or would not have exercised the power.

29 (b) The decisions to which subsection (a) of this section applies include:

30 (1) A decision under G.S. 37A-1-104(a) as to whether and to what extent  
31 an amount should be transferred from principal to income or from  
32 income to principal.

33 (2) A decision regarding the factors that are relevant to the trust and its  
34 beneficiaries, the extent to which the factors are relevant, and the  
35 weight, if any, to be given to those factors in deciding whether and to  
36 what extent to exercise the discretionary power conferred by G.S.  
37 37A-1-104(a).

38 (c) If the court determines that a fiduciary has abused the fiduciary's discretion,  
39 the court may place the income and remainder beneficiaries in the positions they would  
40 have occupied if the discretion had not been abused, according to the following rules:

41 (1) To the extent that the abuse of discretion has resulted in no distribution  
42 to a beneficiary or in a distribution that is too small, the court shall  
43 order the fiduciary to distribute from the trust to the beneficiary an



- 1                    but the fiduciary may pay those expenses from income of  
2                    property passing to a trust for which the fiduciary claims an  
3                    estate tax marital or charitable deduction only to the extent that  
4                    the payment of those expenses from income will not cause the  
5                    reduction or loss of the deduction; and  
6                    c.    Paying from principal all other disbursements made or incurred  
7                    in connection with the settlement of a decedent's estate or the  
8                    winding up of a terminating income interest, including debts,  
9                    funeral expenses, disposition of remains, family allowances,  
10                   and death taxes and related penalties that are apportioned to the  
11                   estate or terminating income interest by the will, the terms of  
12                   the trust, or applicable law.
- 13                   (3)   Unless the will or trust instrument otherwise provides, or the court  
14                   otherwise directs, a fiduciary shall distribute to a beneficiary who  
15                   receives a pecuniary amount outright interest, computed as provided in  
16                   G.S. 24-1 from the date that is one year following the date of death of  
17                   the person whose death gives rise to the payment of the pecuniary  
18                   bequest or the happening of the contingency that causes the income  
19                   interest to end, from net income determined under subdivision (2) of  
20                   this section or from principal to the extent that net income is  
21                   insufficient. However, this subdivision shall not apply to a pecuniary  
22                   bequest:
- 23                   a.    To or for the benefit of a decedent's surviving spouse that is or  
24                   can be qualified for the federal estate tax marital deduction; or  
25                   b.    To or for the benefit of charitable organizations that are  
26                   qualified for the federal estate tax charitable deduction,  
27                   including a charitable remainder trust.
- 28                   (4)   A fiduciary shall distribute the net income remaining after distributions  
29                   required by subdivision (3) of this section in the manner described in  
30                   G.S. 37A-2-202 to all other beneficiaries, including a beneficiary who  
31                   receives a pecuniary amount in trust, even if the beneficiary holds an  
32                   unqualified power to withdraw assets from the trust or other presently  
33                   exercisable general power of appointment over the trust.
- 34                   (5)   A fiduciary shall not reduce principal or income receipts from property  
35                   described in subdivision (1) of this section because of a payment  
36                   described in G.S. 37A-5-501 or G.S. 37A-5-502 to the extent that the  
37                   will, the terms of the trust, or applicable law requires the fiduciary to  
38                   make the payment from assets other than the property or to the extent  
39                   that the fiduciary recovers or expects to recover the payment from a  
40                   third party. The net income and principal receipts from the property  
41                   are determined by including all of the amounts the fiduciary receives  
42                   or pays with respect to the property, whether those amounts accrued or  
43                   became due before, on, or after the date of a decedent's death or an  
44                   income interest's terminating event, and by making a reasonable

1 provision for amounts that the fiduciary believes the estate or  
2 terminating income interest may become obligated to pay after the  
3 property is distributed.

4 **"§ 37A-2-202. Distribution to residuary and remainder beneficiaries.**

5 (a) Each beneficiary described in G.S. 37A-2-201(4) is entitled to receive a  
6 portion of the net income equal to the beneficiary's fractional interest in undistributed  
7 principal assets, using values as of the distribution date. If a fiduciary makes more than  
8 one distribution of assets to beneficiaries to whom this section applies, each beneficiary,  
9 including one who does not receive part of the distribution, is entitled, as of each  
10 distribution date, to the net income the fiduciary has received after the date of death or  
11 terminating event or earlier distribution date but has not distributed as of the current  
12 distribution date.

13 (b) In determining a beneficiary's share of net income, the following rules apply:

14 (1) The beneficiary is entitled to receive a portion of the net income equal  
15 to the beneficiary's fractional interest in the undistributed principal  
16 assets immediately before the distribution date, including assets that  
17 later may be sold to meet principal obligations.

18 (2) The beneficiary's fractional interest in the undistributed principal  
19 assets shall be calculated without regard to property specifically given  
20 to a beneficiary and property required to pay pecuniary amounts not in  
21 trust.

22 (3) The beneficiary's fractional interest in the undistributed principal  
23 assets shall be calculated on the basis of the aggregate value of those  
24 assets as of the distribution date without reducing the value by any  
25 unpaid principal obligation.

26 (4) The distribution date for purposes of this section may be the date as of  
27 which the fiduciary calculates the value of the assets if that date is  
28 reasonably near the date on which assets are actually distributed.

29 (c) If a fiduciary does not distribute all of the collected but undistributed net  
30 income to each person as of a distribution date, the fiduciary shall maintain appropriate  
31 records showing the interest of each beneficiary in that net income.

32 (d) A fiduciary may apply the rules in this section, to the extent that the fiduciary  
33 considers it appropriate, to net gain or loss realized after the date of death or terminating  
34 event or earlier distribution date from the disposition of a principal asset if this section  
35 applies to the income from the asset.

36 "Article 3.

37 "Apportionment at Beginning and End of Income Interest.

38 **"§ 37A-3-301. When right to income begins and ends.**

39 (a) An income beneficiary is entitled to net income from the date on which the  
40 income interest begins. An income interest begins on the date specified in the terms of  
41 the trust or, if no date is specified, on the date an asset becomes subject to a trust or  
42 successive income interest.

43 (b) An asset becomes subject to a trust:

- 1           (1) On the date it is transferred to the trust in the case of an asset that is  
2 transferred to a trust during the transferor's life;  
3           (2) On the date of a testator's death in the case of an asset that becomes  
4 subject to a trust by reason of a will, even if there is an intervening  
5 period of administration of the testator's estate; or  
6           (3) On the date of an individual's death in the case of an asset that is  
7 transferred to a fiduciary by a third party because of the individual's  
8 death.

9           (c) An asset becomes subject to a successive income interest on the day after the  
10 preceding income interest ends, as determined under subsection (d) of this section, even  
11 if there is an intervening period of administration to wind up the preceding income  
12 interest.

13           (d) An income interest ends on the day before an income beneficiary dies or  
14 another terminating event occurs or on the last day of a period during which there is no  
15 beneficiary to whom a trustee may distribute income.

16 **"§ 37A-3-302. Apportionment of receipts and disbursements when decedent dies**  
17 **or income interest begins.**

18           (a) A trustee shall allocate an income receipt or disbursement, other than one to  
19 which G.S. 37A-2-201(1) applies to principal, if its due date occurs before a decedent  
20 dies in the case of an estate or before an income interest begins in the case of a trust or  
21 successive income interest.

22           (b) A trustee shall allocate an income receipt or disbursement to income if its due  
23 date occurs on or after the date on which a decedent dies or an income interest begins  
24 and it is a periodic due date. An income receipt or disbursement shall be treated as  
25 accruing from day to day if its due date is not periodic or it has no due date. The portion  
26 of the receipt or disbursement accruing before the date on which a decedent dies or an  
27 income interest begins shall be allocated to principal, and the balance shall be allocated  
28 to income.

29           (c) An item of income or an obligation is due on the date the payer is required to  
30 make a payment. If a payment date is not stated, there is no due date for the purposes of  
31 this Chapter. Distributions to shareholders or other owners from an entity to which G.S.  
32 37A-4-401 applies are considered to be due on the date fixed by the entity for  
33 determining who is entitled to receive the distribution or, if no date is fixed, on the  
34 declaration date for the distribution. A due date is periodic for receipts or disbursements  
35 that shall be paid at regular intervals under a lease or an obligation to pay interest or if  
36 an entity customarily makes distributions at regular intervals.

37 **"§ 37A-3-303. Apportionment when income interest ends.**

38           (a) In this section, "undistributed income" means net income received before the  
39 date on which an income interest ends. The term does not include an item of income or  
40 expense that is due or accrued or net income that has been added or is required to be  
41 added to principal under the terms of the trust.

42           (b) When a mandatory income interest ends, the trustee shall pay to a mandatory  
43 income beneficiary who survives that date, or to the estate of a deceased mandatory  
44 income beneficiary whose death causes the interest to end, the beneficiary's share of the

1 undistributed income that is not disposed of under the terms of the trust unless the  
2 beneficiary has an unqualified power to revoke more than five percent (5%) of the trust  
3 immediately before the income interest ends. In the latter case, the undistributed income  
4 from the portion of the trust that may be revoked shall be added to principal.

5 (c) When a trustee's obligation to pay a fixed annuity or a fixed fraction of the  
6 value of the trust's assets ends, the trustee shall prorate the final payment if and to the  
7 extent required by applicable law to accomplish a purpose of the trust or its settlor  
8 relating to income, gift, estate, or other tax requirements.

9 "Article 4.

10 "Allocation of Receipts During Administration of Trust.

11 "Part 1. Receipts From Entities.

12 **"§ 37A-4-401. Character of receipts.**

13 (a) In this section, "entity" means a corporation, partnership, limited liability  
14 company, regulated investment company, real estate investment trust, common trust  
15 fund, or any other organization in which a trustee has an interest other than a trust or  
16 estate to which G.S. 37A-4-402 applies, a business or activity to which G.S. 37A-4-403  
17 applies, or an asset-backed security to which G.S. 37A-4-415 applies.

18 (b) Except as otherwise provided in this section, a trustee shall allocate to income  
19 money received from an entity.

20 (c) A trustee shall allocate the following receipts from an entity to principal:

21 (1) Property other than money;

22 (2) Money received in one distribution or a series of related distributions  
23 in exchange for part or all of a trust's interest in the entity;

24 (3) Money received in total or partial liquidation of the entity; and

25 (4) Money received from an entity that is a regulated investment company  
26 or a real estate investment trust if the money distributed is a capital  
27 gain dividend for federal income tax purposes.

28 (d) Money is received in partial liquidation:

29 (1) To the extent that the entity, at or near the time of a distribution,  
30 indicates that it is a distribution in partial liquidation; or

31 (2) If the total amount of money and property received in a distribution or  
32 series of related distributions is greater than twenty percent (20%) of  
33 the entity's gross assets, as shown by the entity's year-end financial  
34 statements immediately preceding the initial receipt.

35 (e) Money is not received in partial liquidation, nor may it be taken into account  
36 under subdivision (2) of subsection (d) of this section, to the extent that it does not  
37 exceed the amount of income tax that a trustee or beneficiary shall pay on taxable  
38 income of the entity that distributes the money.

39 (f) A trustee may rely upon a statement made by an entity about the source or  
40 character of a distribution if the statement is made at or near the time of distribution by  
41 the entity's board of directors or other person or group of persons authorized to exercise  
42 powers to pay money or transfer property comparable to those of a corporation's board  
43 of directors.

44 **"§ 37A-4-402. Distribution from trust or estate.**

1 A trustee shall allocate to income an amount received as a distribution of income  
2 from a trust or an estate in which the trust has an interest other than a purchased interest  
3 and shall allocate to principal an amount received as a distribution of principal from the  
4 trust or estate. If a trustee purchases an interest in a trust that is an investment entity, or  
5 a decedent or donor transfers an interest in a trust to a trustee, G.S. 37A-4-401 or G.S.  
6 37A-4-415 applies to a receipt from the trust.

7 **"§ 37A-4-403. Business and other activities conducted by trustee.**

8 (a) If a trustee who conducts a business or other activity determines that it is in  
9 the best interest of all the beneficiaries to account separately for the business or activity  
10 instead of accounting for it as part of the trust's general accounting records, the trustee  
11 may maintain separate accounting records for its transactions, whether or not its assets  
12 are segregated from other trust assets.

13 (b) A trustee who accounts separately for a business or other activity may  
14 determine the extent to which its net cash receipts shall be retained for working capital,  
15 the acquisition or replacement of fixed assets, and other reasonably foreseeable needs of  
16 the business or activity, and the extent to which the remaining net cash receipts are  
17 accounted for as principal or income in the trust's general accounting records. If a  
18 trustee sells assets of the business or other activity, other than in the ordinary course of  
19 the business or activity, the trustee shall account for the net amount received as  
20 principal in the trust's general accounting records to the extent the trustee determines  
21 that the amount received is no longer required in the conduct of the business.

22 (c) Activities for which a trustee may maintain separate accounting records  
23 include:

- 24 (1) Retail, manufacturing, service, and other traditional business activities;
- 25 (2) Farming;
- 26 (3) Raising and selling livestock and other animals;
- 27 (4) Management of rental properties;
- 28 (5) Extraction of minerals and other natural resources;
- 29 (6) Timber operations; and
- 30 (7) Activities to which G.S. 37A-4-414 applies.

31 "Part 2. Receipts Not Normally Apportioned.

32 **"§ 37A-4-404. Principal receipts.**

33 A trustee shall allocate to principal:

- 34 (1) To the extent not allocated to income under this Chapter, assets  
35 received from a transferor during the transferor's lifetime, a decedent's  
36 estate, a trust with a terminating income interest, or a payer under a  
37 contract naming the trust or its trustee as beneficiary;
- 38 (2) Money or other property received from the sale, exchange, liquidation,  
39 or change in form of a principal asset, including realized profit, subject  
40 to this Article;
- 41 (3) Amounts recovered from third parties to reimburse the trust because of  
42 disbursements described in G.S. 37A-5-502(a)(7) or for other reasons  
43 to the extent not based on the loss of income;





1        If a trustee determines that an allocation between principal and income required by  
2 G.S. 37A-4-409, 37A-4-410, 37A-4-411, 37A-4-412, or 37A-4-415 is insubstantial, the  
3 trustee may allocate the entire amount to principal unless one of the circumstances  
4 described in G.S. 37A-1-104(c) applies to the allocation. This power may be exercised  
5 by a cotrustee in the circumstances described in G.S. 37A-1-104(d) and may be released  
6 for the reasons and in the manner described in G.S. 37A-1-104(e). An allocation is  
7 presumed to be insubstantial if:

8            (1) The amount of the allocation would increase or decrease net income in  
9 an accounting period, as determined before the allocation, by less than  
10 ten percent (10%); or

11            (2) The value of the asset producing the receipt for which the allocation  
12 would be made is less than ten percent (10%) of the total value of the  
13 trust's assets at the beginning of the accounting period.

14 **"§ 37A-4-409. Deferred compensation, annuities, and similar payments.**

15            (a) In this section, "payment" means a payment that a trustee may receive over a  
16 fixed number of years or during the life of one or more individuals because of services  
17 rendered or property transferred to the payer in exchange for future payments. The term  
18 includes a payment made in money or property from the payer's general assets or from a  
19 separate fund created by the payer, including a private or commercial annuity, an  
20 individual retirement account, and a pension, profit-sharing, stock-bonus, or  
21 stock-ownership plan.

22            (b) To the extent that a payment is characterized as interest or a dividend or a  
23 payment made in lieu of interest or a dividend, a trustee shall allocate it to income. The  
24 trustee shall allocate to principal the balance of the payment and any other payment  
25 received in the same accounting period that is not characterized as interest, a dividend,  
26 or an equivalent payment.

27            (c) If no part of a payment is characterized as interest, a dividend, or an  
28 equivalent payment, and all or part of the payment is required to be made, a trustee shall  
29 allocate to income ten percent (10%) of the part that is required to be made during the  
30 accounting period and the balance to principal. If no part of a payment is required to be  
31 made or the payment received is the entire amount to which the trustee is entitled, the  
32 trustee shall allocate the entire payment to principal. For purposes of this subsection, a  
33 payment is not "required to be made" to the extent that it is made because the trustee  
34 exercises a right of withdrawal.

35            (d) If, to obtain an estate tax marital deduction for a trust, a trustee shall allocate  
36 more of a payment to income than provided for by this section, the trustee shall allocate  
37 to income the additional amount necessary to obtain the marital deduction.

38            (e) This section does not apply to payments to which G.S. 37A-4-410 applies.

39 **"§ 37A-4-410. Liquidating asset.**

40            (a) In this section, "liquidating asset" means an asset whose value will diminish  
41 or terminate because the asset is expected to produce receipts for a period of limited  
42 duration. The term includes a leasehold, patent, copyright, royalty right, and right to  
43 receive payments during a period of more than one year under an arrangement that does  
44 not provide for the payment of interest on the unpaid balance. The term does not include

1 a payment subject to G.S. 37A-4-409, resources subject to G.S. 37A-4-411, timber  
2 subject to G.S. 37A-4-412, an activity subject to G.S. 37A-4-414, an asset subject to  
3 G.S. 37A-4-415, or any asset for which the trustee establishes a reserve for depreciation  
4 under G.S. 37A-5-503.

5 (b) A trustee shall allocate to income ten percent (10%) of the receipts from a  
6 liquidating asset and the balance to principal.

7 **"§ 37A-4-411. Minerals, water, and other natural resources.**

8 (a) To the extent that a trustee accounts for receipts from an interest in minerals  
9 or other natural resources under this section, the trustee shall allocate them as follows:

10 (1) If received as nominal delay rental or nominal annual rent on a lease, a  
11 receipt shall be allocated to income.

12 (2) If received from a production payment, a receipt shall be allocated to  
13 income if and to the extent that the agreement creating the production  
14 payment provides a factor for interest or its equivalent. The balance  
15 shall be allocated to principal.

16 (3) If an amount received as a royalty, shut-in-well payment, take-or-pay  
17 payment, bonus, or delay rental is more than nominal, ninety percent  
18 (90%) shall be allocated to principal and the balance to income.

19 (4) If an amount is received from a working interest or any other interest  
20 not provided for in subdivision (1), (2), or (3) of this subsection, ninety  
21 percent (90%) of the net amount received shall be allocated to  
22 principal and the balance to income.

23 (b) An amount received on account of an interest in water that is renewable shall  
24 be allocated to income. If the water is not renewable, ninety percent (90%) of the  
25 amount shall be allocated to principal and the balance to income.

26 (c) This Chapter applies whether or not a decedent or donor was extracting  
27 minerals, water, or other natural resources before the interest became subject to the  
28 trust.

29 (d) If a trust owns an interest in minerals, water, or other natural resources on  
30 January 1, 2004, the trustee may allocate receipts from the interest as provided in this  
31 Chapter or in the manner used by the trustee before January 1, 2004. If the trust acquires  
32 an interest in minerals, water, or other natural resources after January 1, 2004, the  
33 trustee shall allocate receipts from the interest as provided in this Chapter.

34 **"§ 37A-4-412. Timber.**

35 (a) To the extent that a trustee accounts for receipts from the sale of timber and  
36 related products pursuant to this section, the trustee shall allocate the net receipts:

37 (1) To income to the extent that the amount of timber removed from the  
38 land does not exceed the rate of growth of the timber during the  
39 accounting periods in which a beneficiary has a mandatory income  
40 interest;

41 (2) To principal to the extent that the amount of timber removed from the  
42 land exceeds the rate of growth of the timber or the net receipts are  
43 from the sale of standing timber;

1           (3) To or between income and principal if the net receipts are from the  
2 lease of timberland or from a contract to cut timber from land owned  
3 by a trust, by determining the amount of timber removed from the land  
4 under the lease or contract and applying the rules in subdivisions (1)  
5 and (2) of this subsection; or

6           (4) To principal to the extent that advance payments, bonuses, and other  
7 payments are not allocated pursuant to subdivision (1), (2), or (3) of  
8 this subsection.

9           (b) In determining net receipts to be allocated pursuant to subsection (a) of this  
10 section, a trustee shall deduct and transfer to principal a reasonable amount for  
11 depletion.

12           (c) This Chapter applies whether or not a decedent or transferor was harvesting  
13 timber from the property before it becomes subject to the trust.

14           (d) If a trust owns an interest in timberland on January 1, 2004, the trustee may  
15 allocate net receipts from the sale of timber and related products as provided in this  
16 Chapter or in the manner used by the trustee before January 1, 2004. If the trust acquires  
17 an interest in timberland after January 1, 2004, the trustee shall allocate net receipts  
18 from the sale of timber and related products as provided in this Chapter.

19 **"§ 37A-4-413. Property not productive of income.**

20           (a) If a marital deduction is allowed for all or part of a trust whose assets consist  
21 substantially of property that does not provide the spouse with sufficient income from or  
22 use of the trust assets, and if the amounts that the trustee transfers from principal to  
23 income under G.S. 37A-1-104 and distributes to the spouse from principal under the  
24 terms of the trust are insufficient to provide the spouse with the beneficial enjoyment  
25 required to obtain the marital deduction, the spouse may require the trustee to make  
26 property productive of income, convert property within a reasonable time, or exercise  
27 the power conferred by G.S. 37A-1-104(a). The trustee may decide which action or  
28 combination of actions to take.

29           (b) In cases not governed by subsection (a) of this section, proceeds from the sale  
30 or other disposition of an asset are principal without regard to the amount of income the  
31 asset produces during any accounting period.

32 **"§ 37A-4-414. Derivatives and options.**

33           (a) In this section, "derivative" means a contract or financial instrument or a  
34 combination of contracts and financial instruments that gives a trust the right or  
35 obligation to participate in some or all changes in the price of a tangible or intangible  
36 asset or group of assets or changes in a rate, an index of prices or rates, or other market  
37 indicator for an asset or a group of assets.

38           (b) To the extent that a trustee does not account under G.S. 37A-4-403 for  
39 transactions in derivatives, the trustee shall allocate to principal receipts from and  
40 disbursements made in connection with those transactions.

41           (c) If a trustee grants an option to buy property from the trust, whether or not the  
42 trust owns the property when the option is granted, grants an option that permits another  
43 person to sell property to the trust, or acquires an option to buy property for the trust or  
44 an option to sell an asset owned by the trust, and the trustee or other owner of the asset

1 is required to deliver the asset if the option is exercised, an amount received for granting  
2 the option shall be allocated to principal. An amount paid to acquire the option shall be  
3 paid from principal. A gain or loss realized upon the exercise of an option, including an  
4 option granted to a settlor of the trust for services rendered, shall be allocated to  
5 principal.

6 **"§ 37A-4-415. Asset-backed securities.**

7 (a) In this section, "asset-backed security" means an asset whose value is based  
8 upon the right it gives the owner to receive distributions from the proceeds of financial  
9 assets that provide collateral for the security. The term includes an asset that gives the  
10 owner the right to receive from the collateral financial assets only the interest or other  
11 current return or only the proceeds other than interest or current return. The term does  
12 not include an asset to which G.S. 37A-4-401 or G.S. 37A-4-409 applies.

13 (b) If a trust receives a payment from interest or other current return and from  
14 other proceeds of the collateral financial assets, the trustee shall allocate to income the  
15 portion of the payment the payer identifies as being from interest or other current return  
16 and shall allocate the balance of the payment to principal.

17 (c) If a trust receives one or more payments in exchange for the trust's entire  
18 interest in an asset-backed security in one accounting period, the trustee shall allocate  
19 the payments to principal. If a payment is one of a series of payments that will result in  
20 the liquidation of the trust's interest in the security over more than one accounting  
21 period, the trustee shall allocate ten percent (10%) of the payment to income and the  
22 balance to principal.

23 "Article 5.

24 "Allocation of Disbursements During Administration of Trust.

25 **"§ 37A-5-501. Disbursements from income.**

26 A trustee shall make the following disbursements from income to the extent that  
27 they are not disbursements to which G.S. 37A-2-201(2)b. or G.S. 37A-2-201(2)c.  
28 applies:

- 29 (1) One-half of the regular compensation of the trustee and of any person  
30 providing investment advisory or custodial services to the trustee;  
31 (2) One-half of all expenses for accountings, judicial proceedings, or other  
32 matters that involve both the income and remainder interests;  
33 (3) All of the other ordinary expenses incurred in connection with the  
34 administration, management, or preservation of trust property and the  
35 distribution of income, including interest, ordinary repairs, regularly  
36 recurring taxes assessed against principal, and expenses of a  
37 proceeding or other matter that concerns primarily the income interest;  
38 and  
39 (4) Recurring premiums on insurance covering the loss of a principal asset  
40 or the loss of income from or use of the asset.

41 **"§ 37A-5-502. Disbursements from principal.**

42 (a) A trustee shall make the following disbursements from principal:

- 43 (1) The remaining one-half of the disbursements described in G.S.  
44 37A-5-501(1) and G.S. 37A-5-501(2);

- 1           (2) All of the trustee's compensation calculated on principal as a fee for  
2 acceptance, distribution, or termination and disbursements made to  
3 prepare property for sale;  
4           (3) Payments on the principal of a trust debt;  
5           (4) Expenses of a proceeding that concerns primarily principal, including  
6 a proceeding to construe the trust or to protect the trust or its property;  
7           (5) Premiums paid on a policy of insurance not described in G.S.  
8 37A-5-501(4) of which the trust is the owner and beneficiary;  
9           (6) Estate, inheritance, and other transfer taxes, including penalties,  
10 apportioned to the trust; and  
11           (7) Disbursements related to environmental matters, including  
12 reclamation, assessing environmental conditions, remedying and  
13 removing environmental contamination, monitoring remedial activities  
14 and the release of substances, preventing future releases of substances,  
15 collecting amounts from persons liable or potentially liable for the  
16 costs of those activities, penalties imposed under environmental laws  
17 or regulations and other payments made to comply with those laws or  
18 regulations, statutory or common-law claims by third parties, and  
19 defending claims based on environmental matters.

20           (b) If a principal asset is encumbered with an obligation that requires income  
21 from that asset to be paid directly to the creditor, the trustee shall transfer from principal  
22 to income an amount equal to the income paid to the creditor in reduction of the  
23 principal balance of the obligation.

24 **"§ 37A-5-503. Transfers from income to principal for depreciation.**

25           (a) In this section, "depreciation" means a reduction in value due to wear, tear,  
26 decay, corrosion, or gradual obsolescence of a fixed asset having a useful life of more  
27 than one year.

28           (b) A trustee may transfer to principal a reasonable amount of the net cash  
29 receipts from a principal asset that is subject to depreciation, but may not transfer any  
30 amount for depreciation:

- 31           (1) Of that portion of real property used or available for use by a  
32 beneficiary as a residence or of tangible personal property held or  
33 made available for the personal use or enjoyment of a beneficiary;  
34           (2) During the administration of a decedent's estate; or  
35           (3) Under this section if the trustee is accounting under G.S. 37A-4-403  
36 for the business or activity in which the asset is used.

37           (c) An amount transferred to principal under this section need not be held as a  
38 separate fund.

39 **"§ 37A-5-504. Transfers from income to reimburse principal.**

40           (a) If a trustee makes or expects to make a principal disbursement described in  
41 this section, the trustee may transfer an appropriate amount from income to principal in  
42 one or more accounting periods to reimburse principal or to provide a reserve for future  
43 principal disbursements.

1       (b) Principal disbursements to which subsection (a) of this section applies include  
2 the following, but only to the extent that the trustee has not been and does not expect to  
3 be reimbursed by a third party:

4           (1) An amount chargeable to income but paid from principal because it is  
5 unusually large, including extraordinary repairs;

6           (2) A capital improvement to a principal asset, whether in the form of  
7 changes to an existing asset or the construction of a new asset,  
8 including special assessments;

9           (3) Disbursements made to prepare property for rental, including tenant  
10 allowances, leasehold improvements, and broker's commissions;

11           (4) Periodic payments on an obligation secured by a principal asset to the  
12 extent that the amount transferred from income to principal for  
13 depreciation is less than the periodic payments; and

14           (5) Disbursements described in G.S. 37A-5-502(a)(7).

15       (c) If the asset whose ownership gives rise to the disbursements becomes subject  
16 to a successive income interest after an income interest ends, a trustee may continue to  
17 transfer amounts from income to principal as provided in subsection (a) of this section.

18 **"§ 37A-5-505. Income taxes.**

19       (a) A tax required to be paid by a trustee based on receipts allocated to income  
20 shall be paid from income.

21       (b) A tax required to be paid by a trustee based on receipts allocated to principal  
22 shall be paid from principal, even if the tax is called an income tax by the taxing  
23 authority.

24       (c) A tax required to be paid by a trustee on the trust's share of an entity's taxable  
25 income shall be paid proportionately:

26           (1) From income to the extent that receipts from the entity are allocated to  
27 income; and

28           (2) From principal to the extent that:

29               a. Receipts from the entity are allocated to principal; and

30               b. The trust's share of the entity's taxable income exceeds the total  
31 receipts described in subdivision (1) and sub-subdivision (2)a.  
32 of this subsection.

33       (d) For purposes of this section, receipts allocated to principal or income shall be  
34 reduced by the amount distributed to a beneficiary from principal or income for which  
35 the trust receives a deduction in calculating the tax.

36 **"§ 37A-5-506. Adjustments between principal and income because of taxes.**

37       (a) A fiduciary may make adjustments between principal and income to offset  
38 the shifting of economic interests or tax benefits between income beneficiaries and  
39 remainder beneficiaries that arise from:

40           (1) Elections and decisions, other than those described in subsection (b) of  
41 this section, that the fiduciary makes from time to time regarding tax  
42 matters;





- 1                   b.     Whether to apply stock dividends and other noncash dividends  
2                   to income or principal or apportion them as the fiduciary shall  
3                   deem advisable; and  
4                   c.     What expenses, costs, taxes (other than estate, inheritance, and  
5                   succession taxes and other governmental charges) shall be  
6                   charged against principal or income or apportioned between  
7                   principal and income and in what proportions."

8                   **SECTION 4.** G.S. 32-34(b)(3) reads as rewritten:

9                   "(3)   Any power conferred upon the fiduciary in his capacity as a fiduciary  
10                  to allocate receipts and expenses as between income and principal in  
11                  his own favor must be exercised in accordance with the provisions of  
12                  ~~Article 2 of Chapter 37~~ Chapter 37A of the General Statutes, the  
13                  Uniform Principal and Income Act of 1973-2003."

14                  **SECTION 5.** G.S. 36A-130(b) reads as rewritten:

15                  "(b)   If, but for the absence of a direction in the will or trust agreement that accrued  
16                  income shall be paid to the estate of the spouse, a trust created under a will or trust  
17                  agreement for the benefit of the spouse of the testator or the grantor of the trust would  
18                  qualify for the federal estate tax marital deduction under section 2056(b)(7) of the  
19                  Internal Revenue Code or the federal gift tax marital deduction under section 2523(f) of  
20                  the Internal Revenue Code, then, unless the will or trust agreement specifically provides  
21                  otherwise by reference to this section, upon the termination of the income interest all  
22                  accrued or undistributed income of the trust at the death of spouse shall be paid to the  
23                  personal representative of the spouse's estate in accordance with the Uniform Principal  
24                  and Income Act of 1973, ~~Article 2 of Chapter 37~~ 2003, Chapter 37A of the General  
25                  Statutes."

26                  **SECTION 6.** G.S. 160A-234(a) reads as rewritten:

27                  "(a)   Assessments upon real property in the possession or enjoyment of a tenant for  
28                  life, or a tenant for a term of years, shall be paid ~~in accordance with G.S. 37-36(b)~~.by  
29                  the holder of the remainder or reversion, as the case may be."

30                  **SECTION 7.** The Revisor of Statutes shall cause to be printed with this act  
31                  all relevant portions of the official comments to the Uniform Principal and Income Act  
32                  of 1997 and all explanatory comments of the drafters of this act, as the Revisor  
33                  considers appropriate.

34                  **SECTION 8.** This act becomes effective January 1, 2004, and applies to  
35                  every trust or decedent's estate existing on that date or coming into existence after that  
36                  date, except as otherwise expressly provided in the will or terms of the trust or in the  
37                  provisions of Chapter 37A of the General Ststutes, as enacted in this act.